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GOVERNMENT CODE SECTION 10500 et al

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Letter Report 920.2

March 31, 1980

Honorable S. Floyd Mori
Chairman, and Members of the
Joint Legislative Audit Committee
Room 4168, State Capitol
Sacramento, California 95814

Dear Mr. Chairman:

In response to a resolution of the Joint Legislative Audit Committee, we have reviewed milk procurement practices in California school districts and private schools. This review was conducted under the authority vested in the Auditor General under Section 10527 of the Government Code.

Background

Federal regulations require that milk be served with meals provided as part of the National School Lunch Program and the School Breakfast Program. Another federal program, the Special Milk Program, provides supplemental milk to children in schools and in nonprofit child care institutions. Records of the State Department of Education (SDE) indicate that approximately 551 million half pints of milk were served during fiscal year 1978-79 in these programs in California.

Federal and state laws detail food procurement guidelines under which public school districts and private schools must operate. However, school districts and private schools generally contract directly with milk vendors. Each vendor sets his own price for milk.

Members of the
Joint Legislative Audit Committee
March 31, 1980
Page 2

Prior to 1977, wholesale and retail milk prices were controlled by California's Department of Food and Agriculture. Chapter 402 of the Statutes of 1977 repealed minimum wholesale and retail prices for milk. The Department of Food and Agriculture, however, still sets minimum prices for milk at the producer level.

Scope of Review

We visited 16 school districts and six private schools. (Throughout the report, these entities will be referred to as school districts.) We also contacted an additional 15 school districts by phone. The schools included in our survey represented approximately 27 percent of school enrollment statewide for the 1979-80 school year. We selected our sample to include districts and private schools which reported paying extreme high and low and mid-range prices for milk as depicted in SDE's computer listing of milk prices (BCN E305) dated September 12, 1979.

We interviewed directors of school food services, purchasing department staff, and representatives from dairies. We also contacted staff from California's Department of Food and Agriculture. We analyzed pertinent federal and state regulations and reviewed school districts' compliance with milk procurement and competitive bidding regulations. Our review of milk prices also included a comparison of local grocery stores' milk prices in locations corresponding to the school districts selected for our sample.

Study Results

Our review of school districts' milk procurement practices disclosed this information:

- Although the prices school districts pay for milk vary, the greatest volume of milk is purchased at a relatively uniform price;
- SDE's computer data on milk prices does not provide an accurate basis for comparison of milk prices because of variations in reporting;
- School districts could improve their milk procurement practices through competitive bidding.

Members of the
Joint Legislative Audit Committee
March 31, 1980
Page 3

Prices School Districts
Pay for Milk Vary

We found variations in the prices school districts pay for milk. The price for whole milk at the districts we contacted ranged from \$0.1009 to \$0.20 per half pint. Yet statewide, school districts purchase the greatest volume of milk at a relatively uniform price. A number of factors affect the price which districts pay for milk, including student enrollment, container size, location of schools, and others.

The table on page 4 of this report arrays milk prices paid by the school districts we contacted.

A major factor affecting milk prices is student enrollment. In our sample, all but one of the districts with student enrollments exceeding 3,650 paid between \$0.1102 and \$0.1175 per half pint of whole milk. This range indicates that school districts purchase the greatest volume of milk at a relatively uniform price. The smaller school districts generally paid the higher prices. For example, four of the districts in our sample paid over \$0.1360. Each of these districts had student enrollments of 300 or less. The median price paid by school districts in our sample was \$0.1172 per half pint of whole milk.*

Also, the size of the container milk is sold in affects milk prices. Two of the school districts in our sample which paid the lowest prices for whole milk purchased the milk in larger containers. Specifically, Private School F paid \$0.1009 for whole milk, purchasing it by the half gallon. District 12 which purchased milk by the third quart paid \$0.1102. Five of the seven districts which purchased milk in larger containers paid less than \$0.1172, the median price in our sample. Although milk may cost less when purchased by the third quart rather than by the half pint, some schools purchase the half pint because that is as much or more than younger students will drink.

* The median refers to the midpoint in the range of prices.

Members of the
 Joint Legislative Audit Committee
 March 31, 1980
 Page 4

MILK PRICES PAID BY SCHOOL DISTRICTS CONTACTED

| <u>Districts/Schools</u> | <u>Student Enrollment</u> | <u>Price Per Whole Milk</u> | <u>Price Per Half Fat Milk</u> | <u>Price Per Low Fat Milk</u> | <u>Price Per Chocolate** Milk</u> | <u>Price Reported by SDE</u> | <u>Container Size Purchased</u> | <u>Price/Quart Whole Milk at Local Grocery Store</u> |
|--------------------------|---------------------------|-----------------------------|--------------------------------|-------------------------------|-----------------------------------|------------------------------|---------------------------------|--|
| District 1 | 584,000 | .1125 | -- | .1076 | -- | .1099 | 1/2 pint | .4720 |
| District 2* | 118,283 | -- | .1213 | .1132 | .1105 | .1105 | 1/2 pint | .4675 |
| District 3* | 64,037 | -- | .1125 | .1223 | .1184 | .1146 | 1/2 pint | N/A |
| District 4 | 52,000 | -- | .1053 | -- | .1053 | .1032 | 1/2 pint | .4567 |
| District 5* | 51,113 | -- | .0989 | .1042 | .0995 | .0995 | 1/2 pint | N/A |
| District 6* | 47,930 | -- | .1086 | .1063 | .1100 | .1100 | 1/2 pint | N/A |
| District 7* | 42,789 | .1130 | .1086 | .1063 | .1158 | .1158 | 1/2 pint | N/A |
| District 8* | 42,014 | .1172 | .1092 | .1211 | .1221 | .1176 | 1/2 pint | N/A |
| District 9* | 40,275 | .1144 | -- | .1144 | -- | .1163 | 1/3 qt. | .4533 |
| District 10* | 36,597 | .1175 | -- | .1110 | -- | .1116 | 1/2 pint | .4300 |
| District 11 | 27,265 | -- | .1110 | -- | .1055 | -- | 1/2 pint | .4720 |
| Private School A | 23,900 | .1132 | -- | .1088 | .1200 | .1209 | 1/3 qt. | .4675 |
| District 12 | 21,500 | .1102 | -- | .1200 | .1200 | .1192 | 1/2 pint | .4567 |
| District 13 | 18,000 | -- | .1171 | -- | -- | .1159 | 1/2 pint | .4750 |
| District 14 | 17,000 | .1171 | -- | .1220 | -- | .1220 | 1/2 pint | .4300 |
| District 15 | 12,908 | .1220 | -- | -- | .1254 | .1155 | 1/2 pint | .4675 |
| District 16 | 12,000 | .1128 | -- | .1132 | .1086 | .1055 | 1/2 pint | .4720 |
| District 17 | 12,000 | .1125 | -- | .1175 | .1160 | .1160 | 1/2 pint | .4533 |
| District 18 | 9,225 | .1175 | -- | .1193 | .1294 | .1216 | 1/2 pint | .4400 |
| District 19 | 5,600 | -- | .1133 | .1133 | -- | .1110 | 1/3 qt. | .4850 |
| District 20 | 5,600 | .1125 | .1080 | .1225 | .1156 | .1156 | 1/2 pint | .4720 |
| District 21 | 3,650 | .1125 | -- | .1238 | -- | .1500 | .1690 | 1/3 qt. |
| District 22* | 2,001 | .1238 | -- | .1360 | -- | .1660 | .1421 | N/A |
| District 23* | 1,899 | .1360 | -- | .1183 | -- | .1435 | .1075 | .4767 |
| District 24* | 1,099 | .1183 | -- | -- | .1220 | .1277 | .1277 | .4567 |
| Private School B | 950 | -- | .1220 | .1300 | .1300 | .1945 | .1945 | .4675 |
| District 25 | 513 | -- | .1160 | -- | -- | .1093 | .1093 | .4533 |
| Private School C* | 368 | .1250 | -- | .1250 | -- | .1257 | .1257 | .4675 |
| Private School D | 344 | .1200 | -- | .1300 | .1250 | .1424 | .1424 | .4675 |
| District 26 | 325 | .1300 | -- | .1892 | -- | .1299 | .1299 | .467 |
| Private School E | 300 | .1892 | -- | -- | .2064 | .1945 | .1945 | .4675 |
| Private School F | 237 | .1009 | -- | -- | -- | -- | .1/2 gal. | .4750 |
| Private School G* | 235 | .1500 | -- | -- | -- | -- | .1/2 pint | .4675 |
| District 27 | 230 | .1700 | -- | -- | -- | .0902 | .0902 | .4525 |
| Private School H* | 120 | .1150 | -- | -- | -- | .0853 | .0853 | .4720 |
| District 28* | 113 | .2000 | -- | -- | -- | .1993 | .1993 | .4850 |
| Private School I | 62 | .1148 | -- | -- | -- | .1189 | .1189 | .4525 |

*Districts and private schools contacted by telephone.

**Includes low fat and nonfat chocolate milk.

Members of the
Joint Legislative Audit Committee
March 31, 1980
Page 5

Geographical location of the school district also affects milk prices. District 28, a small, rural district, paid the highest price in our sample for whole milk--\$0.20. Since there is no dairy or milk vendor within 30 miles of this district, it purchases milk at the local grocery store. Another small, rural district we visited paid \$0.17 per half pint of whole milk. School officials told us that only one dairy delivers to the town.

Another reason why location affects milk prices is that the price of milk at the producer level is set based on geographical considerations. The Department of Food and Agriculture controls the price of milk at the producer level in eight areas throughout the State. The minimum rates are set based on local costs of production and are adjusted at least every two months.

School district officials and dairy representatives told us that milk prices were also affected by escalation clauses, the size of milk orders, the distance between the dairy and the delivery location, and the time milk is delivered.

Milk prices may be affected by escalation clauses which tie the price charged districts to related producer costs. One dairy's contracts to supply milk to school districts statewide include an escalation clause that ties the milk price to the minimum producer price set by the Department of Food and Agriculture. Since the producer price is adjusted every two months, this dairy's prices change also. An escalation clause in another dairy's contract allowed a change in milk price only if production costs increased or decreased by more than 5 percent. Since production costs for this dairy had not changed by more than 5 percent, the price charged the district had not changed.

In addition, the distance between the dairy and the delivery location as well as the time of delivery and order size affect the milk price. Because of high labor costs, deliveries requiring the least time for transportation will usually cost less. Time of delivery is another factor which influences milk pricing. Dairies may allow discounts for early morning or night deliveries since at these times dairies are better able to utilize their equipment. Also, a dairy may offer a lower price if the size of the order placed by a school district is large enough to allow maximum efficiency of the dairy's equipment. Other factors affecting milk prices include number of delivery locations, frequency of delivery, and type of delivery services, such as placing the milk in refrigerators.

Members of the
Joint Legislative Audit Committee
March 31, 1980
Page 6

SDE's Milk Price List Does Not
Provide an Accurate Basis for
Comparison of Milk Prices

Each month school districts are required to report to the State Department of Education the total number of half pints of milk purchased and the total price paid. The department uses this information to compute an average price paid by each district. Then, from this data, the department compiles a computer listing of these prices. The United States Department of Agriculture uses this information in determining reimbursement rates for child nutrition programs. We found, however, that SDE's price listing does not provide an accurate basis of comparison for milk prices because (1) the listing does not reflect actual prices paid for the milk, (2) the listing does not reflect comparable months of participation, and (3) school districts do not report the data in a consistent manner.

The milk price data on SDE's computer listing do not reflect comparable prices because school districts report a total price for all types of milk purchased and are not required to indicate the types of milk the reported price is based on. When reporting the total price, school districts include whole milk, low fat milk, chocolate milk, skim milk, buttermilk, or bulk milk. Some schools serve only one type of milk while others serve a combination. The price of milk varied depending on the type of milk school districts served. In our sample, the median price for low fat chocolate milk was \$0.1224 per half pint; the median price for whole milk was \$0.1172; and the median price for low fat milk was \$0.1118. Therefore, if one school ordered a larger proportion of chocolate milk than did another, the average price of milk on SDE's listing would be higher for that school.

Another reason the milk prices on the computer listing are not comparable is that the listing shows year-to-date average prices. These figures may be misleading because the listing does not necessarily reflect the data from each participating school district based on similar months of participation. For example, three private schools we contacted have been participating in the school milk program since September 1979, yet the milk price data for these institutions had not yet appeared on SDE's January 1980 price listing.

Members of the
Joint Legislative Audit Committee
March 31, 1980
Page 7

If a school district reports its milk prices later than required, the cost data reflected by SDE's listing do not cover the same time period for that district as for the others. Further, since some school districts reported as many as three price increases since September, this timing difference in reporting may show average price variations that do not exist.

Finally, SDE's milk price listing is unreliable for comparison because school districts are not reporting in a uniform manner. SDE has instructed districts reporting their monthly claims to convert the total volume of milk purchased during the month to half pints. The districts are then instructed to report the total cost paid to the vendor after discounts, if any. SDE then divides the total cost by the number of half pints purchased to determine the average purchase price per half pint of milk.

School districts, however, are not uniformly reporting the volume of milk purchased. For instance, four of the districts we contacted purchased milk in third quarts. Two of these districts simply reported the number of third quarts purchased rather than converting the total volume to half pints. Consequently, the prices on the SDE listing are inaccurate. For one of these districts, the listed price was \$0.1690; we computed the actual cost per half pint of whole milk to be \$0.1238. Another district was listed as paying \$0.1209; the actual cost was \$0.1102 per half pint of whole milk.

School Districts'
Milk Procurement Practices
Could Be Improved

The milk procurement procedures school districts use could be improved. Specifically, districts should avoid sole source purchasing and adopt competitive bidding when possible. Eight districts in our sample purchased milk from a single source without contacting other vendors. Also, 12 of the agencies contacted did not have written vendor specifications or procurement procedures for purchasing milk. Because of these practices, school districts may not be purchasing milk at minimum costs.

Members of the
Joint Legislative Audit Committee
March 31, 1980
Page 8

The U. S. Department of Agriculture recommends that school districts place greater emphasis on competitive bidding and use less sole source purchasing. In its publication, "Food Purchasing Pointers for School Food Service," USDA emphasizes that "regardless of the [procurement] method used, two or more vendors should be contacted when making most food purchases to insure competitive bidding."

According to California state law, however, schools are not required to use competitive bidding for perishable goods or seasonal commodities. An SDE official told us that although milk is considered a perishable commodity for state purposes, it is not a perishable item according to federal regulations. The Department of Education requested an opinion from USDA resolving this conflict. SDE has not yet received a formal response. However, the USDA regional office, in an informal ruling, stated that until the formal decision is announced, the state interpretation will take precedence. Therefore, in California, milk is considered perishable and school districts are not required to use competitive bidding.

Since school districts in California are not required to purchase milk competitively, they may establish their own policies and procedures for purchasing milk. Of the 37 districts we contacted, only 21 used competitive bidding or quotations in purchasing milk. Others used a single supplier or divided their orders among several local dairies.

Some of the school districts we contacted which did not use competitive bidding offered several reasons for their purchasing procedures. In some rural areas, only one dairy is available to deliver milk. The school in one district we contacted purchased milk from the grocery store because no dairy delivered in the area. Other districts have used the same vendor for years and continue with that vendor because they are pleased with the service provided. Another agency we contacted had actually requested multiple bids, but no vendor responded. One large school district split its contracts for milk among 19 dairies because no single dairy could supply the amount of milk needed. Each of these 19 dairies delivers milk at the same price.

Members of the
Joint Legislative Audit Committee
March 31, 1980
Page 9

School districts also lack written guidelines for purchasing milk. Twelve of the 37 school districts we contacted did not use written vendor specifications or procurement procedures for purchasing milk.

Sections 54202 and 54204 of the California Government Code address the necessity of school districts having written procurement policies:

Every local agency shall adopt policies and procedures, including bidding regulations, governing purchases of supplies and equipment by the local agency....

If the local agency is other than a city, county, or city and county, the policies provided for in Section 54202 shall be adopted by means of a written rule or regulation, copies of which shall be available for public distribution.

The State Department of Education has established few guidelines regarding food procurement. Section 39873 of the Education Code states:

Perishable foodstuffs and seasonable commodities needed in the operation of cafeterias may be purchased by the school district in accordance with rules and regulations for such purchase adopted by the governing board of said district notwithstanding any provisions of this code in conflict with such rules and regulations.

Without written vendor specifications and milk procurement procedures, school districts are not assured of receiving milk at minimum costs.

Members of the
Joint Legislative Audit Committee
March 31, 1980
Page 10

Conclusion

The prices school districts pay for milk vary. We found that the prices districts paid ranged from \$0.1009 to \$0.20 per half pint of whole milk. However, school districts purchased the greatest volume of milk at a relatively uniform price. Some of the factors influencing milk prices, such as school location and number of dairies in the area, are beyond the control of school districts. Also, due to the manner in which milk prices are reported on SDE's computer listing, the listing does not provide an accurate basis for comparison of prices school districts pay for milk. We also found that school districts could improve their milk procurement procedures through competitive bidding and use of written vendor specifications.

Respectfully submitted,



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Members of the
Joint Legislative Audit Committee
March 31, 1980
Page 11

RESPONSE TO THE AUDITOR GENERAL'S REPORT

Under Joint Legislative Audit Committee rules, agencies are allowed to respond in writing to draft reports of the Auditor General. We provided the Department of Education a copy of this report; however, the department chose not to respond.